

**Suggested Principles for
Regulating Foreign Investment**

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SUGGESTED PRINCIPLES FOR REGULATING FOREIGN INVESTMENT

Introduction

Foreign investment takes many different forms. Conventionally, foreign investment is divided into two basic types: direct foreign investment and portfolio investment. Direct foreign investment involves direct control and participation in the operation of the recipient firm, while portfolio investment involves passive purchase of investments such as stocks or bonds. Because direct foreign investment and portfolio investment present different advantages and disadvantages to a host country, they are usually treated differently in regimes regulating foreign investment.

Direct foreign investment has a number of advantages over portfolio investment. These include:

- Direct foreign investment not only brings in hard currency to a country, but also carries with it financial resources, managerial skills, technical knowledge and marketing connections.
- Direct foreign investment offers other benefits to a host country, such as improved production techniques, management skills and training of the local work force.
- Direct foreign investment produces backward and forward linkages that may spur substantial economic growth well beyond the foreign investment itself. For example, if a foreign investor sets up a plant to manufacture automobiles, others begin to manufacture tires, batteries, automobile parts and accessories (backward linkages) to supply the auto manufacturer. Still others build gas stations, auto repair shops, automobile insurance agencies, etc. (forward linkages).

- Direct foreign investment is generally long-term investment; portfolio investment is often short-term and can shift extremely rapidly out of the country.
- In contradistinction to foreign loans or bonds, direct foreign investment does not create debts. If the investment is financially unsuccessful, the investor is usually responsible for all losses.

The type of regulatory regime for foreign investment that a host government decides to adopt depends upon whether the government wishes to encourage or to discourage foreign investment in general, or to encourage particular types of investments and to discourage others. It is also a function of to what extent those framing the legislation believe that governmental regulation can improve upon the situation that would prevail if there were no regulation. There is little agreement about whether foreign investment requires any specific regulation.

There is, however, general agreement that developing countries need substantial amounts of foreign investment to speed economic growth and to promote development. The days of prohibiting or discouraging foreign investment have passed. Moreover, the free market has triumphed over centrally planned economies. Even Russia and China, once the leading proponents of centrally guided economies and virulent critics of foreign investment as cloaks for imperialism, have opened both their economies and their doors to foreign investors. Therefore, in elaborating a set of principles for foreign investment regulation, I have assumed that the primary purpose of these principles is to encourage direct foreign investment and coincidentally portfolio foreign investment. I have also relied heavily upon the "Guidelines on the Treatment of Foreign Direct Investment" issued by the Development Committee of the World Bank Group on September 25, 1992 and published in 31 International Legal Materials 1363 (1992). These Guidelines are not meant to be binding upon foreign governments nor to regulate activities of foreign investors;

rather they are designed as a checklist for legislators to reformulate their foreign investment legislation.

The case for a foreign investment regime that encourages foreign investment is straightforward and is no longer seriously controversial. Foreign investment transfers much needed capital, managerial skills, and technology to the host country. It also improves economic efficiency through gains resulting from increases in international trade, international competitiveness, improved access to foreign markets for domestic products, and increased training for the labor force. There are legitimate concerns about unfettered foreign investment, but most of these concerns have to do with the activities of foreign investors and are frequently concerns with respect to the activities of domestic investors as well.

These suggested principles are divided into seven parts. The first deals with admission of foreign investment, the second with fair notice of the rules of the game, the third with treatment of the foreign investor, the fourth with concessions, the fifth with transferability of funds, the sixth with expropriation, and the seventh with dispute settlement.

I - Admission of Foreign Investment

GENERAL PRINCIPLE: The host government should facilitate and encourage the entry of foreign investment, avoiding any cumbersome or delay causing admission procedures.

Foreign investment ought to be allowed to enter freely any lawful activities in the host country, subject to limitations resulting from the host country's sovereign right to restrict certain activities to the public sector or to its own nationals. Such limitations, however, should be drawn as narrowly as possible to restrict only those foreign investments which, in the carefully considered opinion of the host country, interfere with national security or

clearly defined development objectives reserving certain activities either to the public sector or to its own nationals.

COMMENTARY: A number of countries, including Angola, have various forms of screening and approval procedures that restrict direct foreign investment. In developing countries, registration and approval procedures almost invariably cause an inordinate amount of delay. For example, in Egypt, seven years was required to secure approval for a joint venture between GM and Isuzu, and Michelin needed more than seven years to obtain approval to build a tire plant.

The most common rationale for screening requirements is that governments need to determine whether a particular foreign investment is desirable. But there are no good economic criteria for determining whether a particular investment is desirable. For example, Article 3 of Angola's Foreign Investment Law contains three criteria for admissibility of foreign investment. Foreign investment will only be permitted if it does not contravene: (1) "strategies for economic and social development defined by the competent sovereign agencies," (2) "strategic orientation and objectives established in programs of economic policy," and (3) "the legislation in force." The first two criteria are tattered remnants of the now discredited belief in the advantages of a centrally planned economy. All are so vague that they provide little guidance either to foreign investors or to the officials administering them. The only way that a prospective foreign investor can discover whether his contemplated investment runs afoul of these vague criteria is to submit his proposal and await the Foreign Investment Institute's response.

There are at least three serious costs associated with this basic approach: (1) lengthy delays in approving proposed foreign investment projects; (2) waste of bureaucratic personnel, who could be more profitably performing other tasks; and (3) the myriad opportunities for

corruption created by unbridled discretion in approving or disapproving foreign investment proposals.

It makes much more sense for entry of foreign investment to be automatic unless it is unlawful. Proposed investments may be unlawful because they are in an area that is reserved to the government or to nationals, or because they violate certain existing legislation, such as environmental protection laws. Such screening is legitimate, but can be handled more efficiently by the Justice Ministry than by the Foreign Investment Institute, whose role should be redefined as the promotion and facilitation of foreign investment.

The real case for a screening procedure is that it enables the host country to negotiate a higher return from foreign investment for the host country. The screening and approval procedures essentially function as a bargaining chip for controlling foreign investment and for negotiating a better deal for the host country than would be supplied by the investor without the screening procedure. But any benefit seems decidedly marginal when weighed against costs of screening procedures. These costs include lost foreign investment, development of substantial bureaucracies, requirement of unnecessary and expensive feasibility studies, long delays, and increased corruption that captures all or part of the benefit.

Many countries desire to preclude foreign investment from certain sensitive areas, such as ownership of land near border areas, manufacture of armaments, or ownership of the news media. These are legitimate concerns, but they do not require the complex bureaucracies involved in screening and approving most foreign investment. Another legitimate concern is preventing foreign investments from dominating the host country's economic and political life, but this can be achieved through better measures than screening foreign investment. There is virtually no

agreement as to what is good and bad foreign investment. Screening procedures have the undesirable effect of discouraging foreign investment and delaying investment that is needed sooner rather than later. For example, Ecuador had a history of approving almost all applications from reputable companies, but would do so only after causing prospective investors to go through a negotiation process that delayed their investments for many years.

The wording of this general principle reflects the position of many modern foreign investment laws and recent bilateral and multilateral investment treaties. These have sought to eliminate admission requirements and screening procedures for direct foreign investment and to open up as much of the economy as possible to foreign investment. Principle I does not define or attempt to restrict what constitutes a foreign investment. It is meant to cover all forms of foreign investment: direct, portfolio, contractual, licensing, franchising, loans, equipment, technology, concessions, and services. On the other hand, it also permits certain restrictions on admission of foreign investment, recognizing that the host government has a clear right to restrict certain activities to itself or its nationals. It does not prevent countries from establishing government monopolies over particular activities, such as nuclear power, railroads, airlines, or public utilities. Nevertheless the trend has been to privatize many of these activities in the interest of reducing government budgetary deficits, insuring needed infusions of capital and modern technology, and to make them operate more efficiently.

Implementation of Principle I would require Angola to eliminate prior screening of foreign investment by the Foreign Investment Institute for determination of whether it complies with developmental priorities or for negotiation of special deals and privileges. As a general rule, special deals and privileges for foreign investment should be avoided, and there should be no

discrimination between national and foreign investment. The restrictions against foreign investment in certain areas can be maintained. Hopefully, the dubious prohibition against foreign investment in telecommunications will be reexamined, for its likely effect is to retard development of a modern telecommunications industry.

II - Fair Notice of the Rules of the Game

GENERAL PRINCIPLE: The host country should publish a handbook or pamphlet, readily available to prospective and present foreign investors, containing adequate and current information about the rules and procedures relating to foreign investment.

Accurate translations of the relevant constitutional, statutory, treaty provisions and regulations governing foreign investment should also be made available in widely used languages such as English, French, Spanish and German.

COMMENTARY: The foreign investor needs to know what are the rules of the game both before and after making commitments to invest. Countries that wish to attract foreign investment normally publish pamphlets or handbooks containing up-to-date collections of relevant legislation governing foreign investment. At a minimum, such a handbook should include relevant constitutional provisions, treaties in force, the Foreign Investment Law and its Regulations, Law 13 of 1994, Law No. 1 of 1992 (Law of Geological and Mining Activities), Law 16 of 1994 (the Diamond Law), Law 13 of 1978 (Law Regulating Petroleum Activities), the latest Exchange Control Law, and the relevant portions of the latest tax and labor legislation. For a country like Angola, where this information is relatively difficult to find, it is important that this legislation be updated often and published not only in Portuguese, but also in accurate translations into English, French, Spanish and German and perhaps Japanese. These guidebooks or pamphlets should be

available from the Foreign Investment Institute and every Angolan consulate and embassy. They should also be sent to law libraries and chambers of commerce in capital exporting countries.

III. Treatment of the Foreign Investor

GENERAL PRINCIPLE: The host country shall extend to all foreign investment established in its territory, as well as to all foreign personnel, fair and equitable treatment. This guaranty extends to granting work visas, permits, import and export licenses, and the protection and security of the foreign investors and their personnel. It also means that the foreign investor will receive full protection of his property or ownership rights, including intellectual property rights. The host government shall take adequate measures to prevent corruption and to promote accountability and transparency in dealing with foreign investors. Except for areas where foreigners are not similarly situated to nationals for purposes of investing or operating a business, such as areas where investment is restricted to nationals, national legislation and regulations will not discriminate against foreign investors or among foreign investors on grounds of nationality.

COMMENTARY: This principle establishes the general standard of fair and equitable treatment for foreign investors, a principle frequently found in multilateral and bilateral investment treaties. It is worded broadly to indicate that it applies not just to making an investment, but also to operating and eventually to selling or liquidating the investment. The guaranty of fair and equitable treatment covers both personnel and property. Investment requires security, and it is people, rather than things, that feel secure or insecure. It is essential people feel secure not only with respect to property rights but also as to their own persons.

Principle III also means that the host government should promptly issue any licenses,

permits, visas, or authorizations for admitted investment to operate smoothly and effectively. To the extent necessary for efficient operation of the foreign firm, the host government should also authorize visas and work permits for the foreign personnel of the firm. As will be explained more fully below, this does not preclude the host country from requiring the foreign investor to make a good faith effort to recruit personnel from the local work force, but it should guarantee the foreign investor's ability to bring in and employ high-level managers regardless of their nationality.

Foreign investors, particularly U.S. investors and more recently, the 29 members of the Organization for Economic Cooperation and Development (OECD) countries, are reluctant to invest if laws and regulations are administered in a fashion that bribery of government officials is another cost of doing business. The new OECD anti-bribery convention obligates member nations to enact legislation similar to the U.S. Foreign Corrupt Practices Act, which makes it a criminal offense for U.S. persons to bribe foreign officials to secure any business. Therefore, Principle III requires the host government to take adequate measures to prevent corruption and to promote accountability and transparency in dealing with foreign investors.

The principle of non-discrimination is another important aspect of security. In addition to being treated fairly and equitably, foreign investors should not be discriminated against because of their status as aliens. Foreigners ought to be treated as well as nationals and not be placed at a disadvantage in securing permits or authorizations to operate in the country. Nor should they be required as a condition of entry to agree to export a certain percentage of their products or to maintain a certain percentage of domestic content in their products.

On the other hand, the principle of non-discrimination does not apply across the board. In certain areas, foreigners are not similarly situated with nationals and need not be treated equally.

Since Principle I recognizes that a host country may legitimately reserve certain areas to national investors, Principle III should not prevent such discrimination. Nor should a host country have to afford to foreigners the same subsidies it bestows upon its citizens. Thus, government banks or agencies can offer subsidized loans only to domestically controlled firms without offending this principle of non-discrimination because foreigners are not similarly situated with domestic firms for purposes of a governmental determination to subsidize interest rates.

Some investment codes still require foreign investors to recruit a minimum percentage of their employees locally, although the modern trend is to allow freedom in hiring. Because it is usually far more expensive to recruit and to employ foreign personnel, economic considerations will force foreign investors to recruit locally as many workers as feasible without the constraints of law. Principle III allows the host country to require foreign investors to make good faith efforts to recruit the bulk of their labor force locally. Foreign investors may be required to advertise their jobs locally and use local employment agencies before employing foreigners in non-managerial positions and lower level managerial positions. But if good faith efforts fail to turn up needed personnel, foreign investors should be able to bring in foreigners to fill positions that cannot be filled domestically.

IV. Concessions

GENERAL PRINCIPLE: Concessions or permits to operate public utilities or to exploit natural resources should be awarded only after a fair and transparent process of competitive bidding. Invitations to bid should contain clear descriptions of the public service, public work, or mineral area to be exploited; the terms of the bidding; the pre-qualifications to bid; the availability of feasibility studies or prospecting reports; and the

criteria for evaluation of bids. The terms and conditions contained in the invitation to bid shall be incorporated into the concession contracts or permits. Except for income taxes, the creation, modification or abolition of any taxes or legal charges after presentation of the bids requires upward or downward revision in the compensation of the concessionaire.

COMMENTARY: Concessions and permits are valuable resources to the host country. They can be a substantial source of corruption, however, if the procedures by which they are awarded are not open to public view. This principle contemplates that all concessions and permits should be awarded by open competitive bidding as a means of maximizing returns to the host government, insuring fairness and equal treatment to all prospective bidders, insuring the lowest public utility rates to the public, and reducing the amount of corruption frequently associated with non-transparent bestowal of valuable concessions or permits. Absolutely critical is the establishment of open competitive bidding. This involves careful preparation of the invitation to bid (*edital*) so that prospective bidders know precisely what they are bidding for, what are the criteria by which their bids will be evaluated, and what technical and financial resources are needed to qualify as a bidder. The terms of the invitation to bid are then incorporated into a binding concession contract that cannot be unilaterally changed in a way that affects the economic or financial equilibrium of the contract without compensation. In this fashion, concession contracts and permits become more secure juridical instruments and will be awarded on solely economic and technical criteria.

Bidders can compete with respect to how much they are willing to offer to the government for the concession, the quality of the public service, the rate structure, or some combination of these factors. For Angola, such a procedure should be most useful in the area of

diamond and oil exploration and exploitation.

V. Transferability of Funds

GENERAL PRINCIPLE: Foreign investors shall be allowed freely to reinvest or freely to remit abroad without delay the net profits from their investments. They shall also be allowed freely to service their foreign debts attributable to their investments by remitting the interest and amortization payments as they fall due, as well as to discharge any other contractual obligations, such as royalties or license fees, as they fall due. Foreign personnel shall be allowed to remit freely and without delay a reasonable portion of their wages each month, and to transfer immediately all their savings from such wages upon termination of their employment. Such transfers shall be made in freely usable currency and at the applicable spot market rate of exchange for the applicable currency at the time of transfer.

When the foreign investment is liquidated or otherwise disposed of, either in whole or in part, the investor should be allowed freely to reinvest or to repatriate the net proceeds of the liquidation, sale, or compensation award in freely usable currency or any other currency acceptable to the investor unless the host country's foreign currency reserves fall below a level needed to finance three months of imports, in which case the repatriation may be spread over a period of up to five years. During any period that such transfer is blocked for balance-of-payments reasons, the sums awaiting transfer shall bear interest at the normal market rate for the local currency deposited for transfer between the date of deposit until the date of transfer.

COMMENTARY: Encouragement of foreign investment requires minimization of

restraints upon the free transferability of funds out of the host country. Foreign firms need to be able to remit after-tax profits freely to their shareholders, as well as to service their loans, to pay for technology, and to pay for needed imports. Foreign investors should also have the option to reinvest their profits, and indeed should be encouraged to do so. In addition, expatriate personnel need to be able to send home at least part of their wages or salaries each month.

Reflecting the trend in a number of modern investment codes and bilateral treaties, Principle V anticipates that the proceeds from sale, liquidation, or expropriation of an investment should also be freely remittable or capable of being freely reinvested, at the option of the foreign investor. Recognizing, however, that the amounts involved from sale or other disposal, including expropriation, of an investment may sometimes be large and that a country may be undergoing a balance-of-payments crunch when a request to repatriate a large amount comes in, this principle permits deferral of such a request for up to five years. Interest at normal market rates in local currency must be paid on all sums deposited for transfer during the time such transfer is blocked. To avoid dispute about the severity of the balance-of-payments crisis, Principle V adopts the objective criterion of reserves sufficient to purchase the next three months worth of imports. In many cases, this problem will not arise because the investment will be sold or otherwise transferred to another foreign investor outside the host country.

Nothing in Principle V should be understood to prevent a host government from preventing a transfer through nondiscriminatory, equitable and good faith application of its legislation dealing with: (a) bankruptcy or insolvency, (b) alimony or support obligations, (c) criminal offenses, or (d) ensuring satisfaction of judgments in ordinary civil litigation.

VI. Expropriation

GENERAL PRINCIPLE: A host government may not directly or indirectly expropriate or nationalize a foreign investment within its territory or take a measure tantamount to expropriation or nationalization except: (a) for a public purpose, (b) in accordance with applicable legal procedures, (c) without discrimination on the basis of nationality, and (4) upon payment of appropriate compensation. Compensation will be deemed "appropriate" if it is adequate, prompt and effective.

COMMENTARY: The principle is drafted broadly to include "creeping expropriation" (*desapropriação indireta é o termo jurídico mais perto*) as well as formal expropriation or nationalization. Creeping expropriation involves regulatory measures that deprive the foreign investor of some but not all of the indicia of ownership, stopping short of taking formal legal title. Such measures include forcing the foreign investor to flee the country, denying the investor access to its funds and profits, coercing the investor to sell or transfer at an unfairly low price, interfering with access to needed facilities and supplies, or appointing an intervenor or administrator to manage the foreign investment.

Angola's Foreign Investment Law adopts the compensation standard of prompt, adequate and effective, which conforms to this standard and to international law. The thorniest problem in any expropriation, however, is the appropriate valuation of the foreign investment. The public purpose and legal procedure requirements seldom come into play. The great bulk of expropriation disputes are about what is the appropriate value for compensation.

Compensation is adequate if it reflects the fair market value of the investment immediately prior to the taking. Fair market value is normally the sum that a willing buyer would pay for the

investment. Unfortunately, in many cases, there is no such buyer. In default of a willing buyer, if the expropriated firm is operating at a profit, international tribunals and arbitrators have often resorted to "going concern value." This is usually determined by discounting the stream of future earnings. For unprofitable investments, liquidation value is often utilized. For other assets, replacement or book value may be used. Of course, in an inflationary economy book value is often meaningless unless there is a monetary correction for the inflationary distortions.

Compensation is considered "effective" if paid in currency that can be freely converted or is deemed freely usable by the International Monetary Fund. It is also effective if paid in any currency acceptable to the foreign investor.

Compensation is regarded as "prompt" if paid without delay. Compensation paid in bonds or some other deferred method of payment is regarded as neither prompt nor effective.

If, for non-commercial reasons, a host government unilaterally terminates a concession or alters a contract with a foreign investor in a way that alters its financial-economic equation, compensation is due under this principle.

VII. Dispute Settlement

GENERAL PRINCIPLE: Disputes between the host country and foreign investors will normally be settled by negotiations. If these are unsuccessful, disputes shall be settled by the national courts or by other agreed upon alternative dispute resolution mechanisms, such as arbitration, conciliation or mediation.

COMMENTARY: Investment disputes are usually resolved by negotiations. If these fail, the normal route is to litigate in the courts of the host country, unless by contract or some other mechanism, the parties have agreed to some form of alternative dispute resolution, such as

arbitration, mediation or conciliation. Because of concern about a level playing field when litigating against a sovereign country in the sovereign's own courts and the awkwardness of a sovereign litigating in another country's courts, provisions for international arbitration are common. Such provisions enable the parties to choose the arbitrators, the applicable law, and the place of arbitration.